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LESSONS LEARNED FROM A POLICY DIALOGUE:

WHEAT PRICE POLICIES IN PAKISTAN

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ACRONYMS

ARD	(Office of) Agriculture and Rural Development
ASSP	Agricultural Sector Support Program
CIMMYT	International Maize & Wheat Improvement Center (in Spanish)
EPAD	Economic and Policy Analysis Division
HIES	Household Income and Expenditure Survey
HYV	High-Yielding Variety
IJI	Islamic Democratic Alliance (in Urdu)
PASSCO	Pakistan Agricultural Storage and Services Corporation
PPP	Pakistan Peoples' Party

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EXECUTIVE SUMMARY

Under its Agricultural Sector Support Program (ASSP), USAID/Pakistan has carried on a policy dialogue with the Government of Pakistan. The Mission and the Government annually have agreed on a set of policy reforms ("benchmarks") that the Government will implement. For its part, USAID has provided balance of payments support, a "sector grant," to the Government. To support the benchmark program, the Mission required a high level of policy analysis capability. For this reason, the Mission included policy project support as one of the activities in its buy-in to the Agricultural Policy Analysis Project, Phase II (APAP II).

Through APAP II's involvement in the policy reform process in Pakistan, the following lessons have been learned:

- Through policy dialogue, a Mission can make major progress in achieving policy objectives like reducing price distortions and subsidies or promoting privatization. Policy benchmarks can also be useful in reinforcing project activities in institutional strengthening.
- In order to make progress in policy reform, USAID Missions must have a high level of policy analysis capability available to them. While this function is not entirely new to USAID, the pressure of implementing projects on a day-to-day basis often takes precedence over longer-run activities like analysis. Ancillary necessities like databases and libraries, which are crucial to policy analysis, may also receive little attention from personnel preoccupied with other business.
- The "sector grant" (*i.e.*, balance-of-payments support, or fast-disbursing assistance) is in general not flexible enough to send different signals to technical experts and to politicians.
- Changes of government may not be damaging to a policy dialogue if technical experts remain in positions of influence. Dialogue complemented by targeted training can be particularly productive. Political weakness may hamper implementation or cause backsliding.
- If the Government makes a policy objective a "benchmark," it may help its implementation. That is, formalizing the Government's acceptance of a proposed action may prevent slippage of support from certain quarters within the Government.
- There is a strong tendency for (developing) countries to favor the agricultural producer only after national income has increased substantially and the share of agriculture (producers) has decreased. To some extent this will limit the pace of policy reform.

1. INTRODUCTION

In the 1980s, Pakistan's wheat policies taxed its producers and subsidized its consumers. Moreover, the post-rationing (post-1987), open-ended system of government wheat distribution has increased the burden on the government budget. The Government now faces severe shortages of resources at a time when human capital and physical infrastructure must be developed and maintained.

Under the Agricultural Sector Support Program (ASSP), USAID/Pakistan has carried on an agricultural policy dialogue with the Government of Pakistan. The Mission and the Government annually have agreed on a set of policy reforms ("benchmarks") that the Government will implement. The wheat release price-procurement price gap has always been the most important benchmark for the Mission.

This paper draws lessons from this policy dialogue. To set the dialogue in a meaningful context, the first sections describe the trends in wheat production, marketing, consumption, and related policies.

2. WHEAT PRODUCTION

Wheat is in several ways the dominant crop in Pakistan. The area under wheat is more than three times that under cotton or rice, the next most extensive crops, and wheat is grown on the majority of farms in Pakistan, both large and small (Table 1). About half the wheat is grown after cotton. Most of this wheat is planted late and yields substantially less than it could if planted earlier. The producer price and profitability of both wheat and cotton are depressed by government policies, but cotton remains more profitable. CIMMYT studies have shown that wheat-cotton farmers are rational in taking extra pickings of cotton and planting wheat late, given the prices they receive¹. The average wheat yield has risen since the Green Revolution, due to the adoption of HYVs. However, the yields of HYVs have not risen.

Table 1 Pakistan: Distribution of Wheat Farms by Size, 1980

Size of Farm	Total Farms	Number of Farms Growing Wheat	Percent of Wheat Farms	Percent of Total Farms
< 1.0 acre	184,067	113,949	3.3%	62%
1.0 - 2.5	517,358	404,050	11.8%	78%
2.5 - 5.0	685,026	580,546	17.0%	85%
5.0 to 7.5	684,585	592,664	17.3%	87%
7.5 to 12.5	919,353	801,164	23.4%	87%
12.5 to 25.0	705,173	615,698	18.0%	87%
25 to 50	263,699	220,812	6.5%	84%
50 to 150	96,141	77,517	2.3%	81%
> 150 acres	14,027	11,300	0.4%	81%
Total	4,069,429	3,417,700	100.0%	84%

Source: Government of Pakistan, Agricultural Census Organization, Census of Agriculture, 1980, All-Pakistan Report, p. 27.

¹ Akhtar, M. Ramzan, et al., 1986, Wheat in the Cotton-Wheat Farming Systems of the Punjab: Implications for Research and Extension, PARC/CIMMYT Paper no. 86-8, Pakistan Agricultural Research Council, p. 24.

Wheat production in Pakistan has trended upward. Despite increases in yield and production, however, Pakistan has not achieved self-sufficiency in wheat. Table 2 shows Pakistan's wheat imports in the 1980s. Generally, when Pakistan imported less than 1 million tons of wheat in a given year, the wheat was imported through the World Food Program for Afghan refugees, not for Pakistanis. Nevertheless, in five of the last seven years, Pakistan has imported significant amounts of wheat for its own account.

Table 2 Pakistan: Elements of Wheat Supply and Distribution, 1980/81 - 1990/91

Marketing Year	Area	Yield	Production	Opening stocks	Imports
(May/Apr)	1,000 ha	kgs/ha	-----1,000 tons-----		
1980/81	6924	1568	10857	685	320
1981/82	6984	1643	11475	830	346
1982/83	7223	1565	11304	1650	570
1983/84	7398	1678	12414	1620	393
1984/85	7343	1482	10882	1800	1042
1985/86	7259	1612	11703	745	1832
1986/87	7403	1881	13923	1227	374
1987/88	7706	1559	12016	2525	505
1988/89	7308	1734	12675	1200	2240
1989/90	7730	1865	14419	600	2030
1990/91	7845	1825	14316	1522	1050

Sources: Government of Pakistan, Economic Surveys, 1989-90, 1990-91; Ministry of Food, Agriculture, and Cooperatives; U.S. Department of Agriculture, Foreign Agricultural Service.

3. WHEAT MARKETING AND POLICY

After they harvest their wheat, farmers can sell it to the Government (namely to the Pakistan Agricultural Storage and Services Corporation (PASSCO) or the provincial food departments) at the procurement price, or to a private trader at the market price. Wheat moves through both channels. Partly because of procurement regulations and their administration, there are generally differences in quality between the wheat received by the Government and that which goes to traders. Thus two prices may prevail in the market at any given time. (In practice, farmers sell almost all marketed wheat to traders, and traders then sell about half the marketed wheat to the Government.) Both the Federal and Provincial Governments have at times resorted to movement restrictions that tend to bottle up surpluses in certain districts. Clearly this contributes to farmers' receiving lower prices in many areas.

Wheat is Pakistan's staple food, but urban consumers generally do not purchase it as wheat. They buy flour, or in urban areas many buy freshly baked bread. Wheat moves from traders to millers, and the ground wheat eventually moves to consumers. Wheat also moves through the government channel to reach consumers in the form of flour. Until 1987, the Government maintained a ration system that distributed wheat to millers for grinding at a fixed charge and distributed flour to privately-owned, licensed ration shops. Ration card holders could purchase flour at subsidized prices. The Government abolished this system because it was not fulfilling its objective of helping low-income consumers.

While there are no longer ration shops, the Government maintains a substantial presence in wheat marketing. Theoretically, it stands prepared to sell any amount of wheat to anyone at the fixed release price². In practice, there have been some informal restrictions on the amounts released, keyed to numbers of hours of milling operation per day. The current system does not attempt to target any recipient group. Rather, its role is holding down and stabilizing the price of wheat.

Because of the relationships between procurement and release prices, a major role of the Government in wheat marketing has been storage. Table 3 shows that the release price was sometimes below the procurement price, and never higher by the Rs. 400-500 that would fully cover marketing costs. Thus the private sector has not had the incentive to store wheat for most of the marketing year, since it could not earn a sufficient return on its investment in storage facilities. Rather, millers have come to depend on the Government to supply a substantial part of their requirement of wheat, especially during the latter part of the year. This can be seen from seasonal release data in Table 4.

The inadequate gap between release and procurement prices has resulted in a subsidy. The potential burden to the Government of this subsidy on domestic wheat has been reduced,

² There is a minimum purchase of ten tons.

Table 3 Pakistan: Official Wheat Prices, 1976/77 - 1989/90

Crop year	Procurement Price (1)	Release Price (2)	Difference (2-1)	Ratio (2/1)
-----Rupees per metric ton-----				
1976/77	991.25	950.00	(41.25)	0.96
1977/78	991.25	950.00	(41.25)	0.96
1978/79	1,205.75	1,000.00	(205.75)	0.83
1979/80	1,450.00	1,220.00	(230.00)	0.84
1980/81	1,450.00	1,325.00	(125.00)	0.91
1981/82	1,450.00	1,567.40	117.40	1.08
1982/83	1,600.00	1,702.90	102.90	1.06
1983/84	1,600.00	1,702.90	102.90	1.06
1984/85	1,750.00	1,702.90	(47.10)	0.97
1985/86	2,000.00	1,702.90	(297.10)	0.85
1986/87	2,000.00	2,000.00	0.00	1.00
1987/88	2,062.50	2,100.00	37.50	1.02
1988/89	2,125.00	2,300.00	175.00	1.08
1989/90*	2,400.00	2,600.00	200.00	1.08

* Release price was initially announced as Rs. 2,500.

Source: Government of Pakistan, Economic Survey, 1990-91.

however, by the depressed producer price. That is, if the Government had to procure domestic wheat at a price comparable to world wheat prices, the subsidy (between the procurement and release prices) would have been more. The relationship between world prices and domestic producer and consumer prices in the 1980s is shown in Figure 1. While producers have borne part of the subsidy burden on domestic wheat, the burden of importing wheat, when necessary, and releasing it at the subsidized price falls entirely on the government budget. When world prices rise quickly and domestic prices have been raised slowly, the subsidy on imports can be quite large.

Table 4 Pakistan: Monthly Releases of Wheat, 1987/88, 1988/89, and 1989/90

	1987/88	1988/89	1989/90
	Thousand metric tons		
May	262	230	198
June	308	318	168
July	296	328	259
August	278	424	362
September	325	440	367
October	384	547	483
November	453	562	486
December	578	609	530
January	667	665	596
February	566	590	513
March	640	585	522
April	449	439	461

Source: Government of Pakistan, Ministry of Food, Agriculture, and Cooperatives.

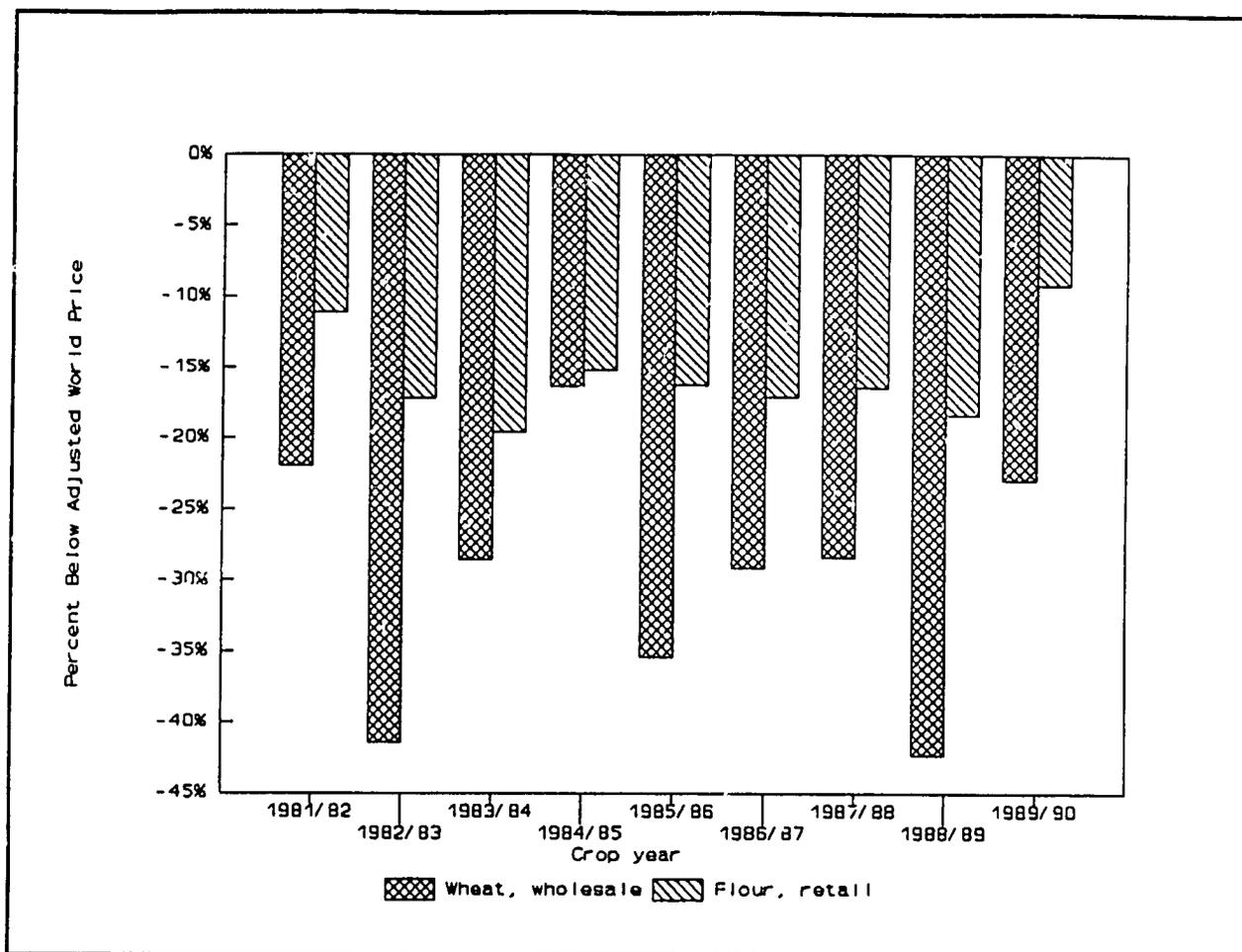
The amounts of recent wheat subsidies are shown in Table 5³. Initially the subsidy arising out of imports was borne by the Federal Government, while the subsidies paid on domestic operations were carried by provincial budgets. Eventually, however, because of block grants from the Federal Government to the Provinces, the entire cost of wheat operations was shouldered by the Federal Government⁴.

These amounts are quite substantial in comparison to Pakistan's economy and government expenditures. The largest subsidy, in 1988/89, was about 1 percent of GDP and about 6 percent of total government revenue (or about 13 percent of the difference between total revenue and total expenditures). Pakistan is currently under a combination World Bank structural adjustment loan and IMF standby arrangement, under which various fiscal targets, including reduction of the fiscal deficit, have been set.

³ Data relating to the federal subsidy are from federal budget documents. The provincial subsidies have been taken from annual Economic Surveys.

⁴ The system of block grants was recently abolished.

**Figure 1 Pakistan: Wheat Price Distortions
(International Parity Price Comparisons), 1981/82 - 1989/90**



In the latter half of the 1980s, the Government has been removing subsidies on fertilizer. In the last two years (1989/90 and 1990/91), the Government has recognized the "squeeze" this put on farmers, and it has also significantly raised the procurement price of wheat. However, as can be seen in Figure 1, it remains below the adjusted world price. The increases in procurement price have made it harder for the Government to increase the gap between the release and procurement prices, for to do so, the release price would have to rise even faster than the procurement price. Thus the ratio rose to its historical high of 1.08, but no further. The Government has also improved cost recovery in its marketing operations by charging more for the bags in which it distributes wheat. Nevertheless, the basic price structure has not changed with the abolition of rationing.

Two aspects of the post-rationing system (*i.e.*, since 1987) have been disturbing. One is the higher levels of releases, shown in Table 6. Once the Government demonstrates that it is willing to store and distribute certain quantities of wheat, it may be more difficult to decrease this quantity and/or return this function to the private sector. Moreover, while the domestic subsidy has edged downward, the government of Benazir Bhutto also demonstrated its willingness

Table 5 Pakistan: Wheat Subsidies, 1986/87 - 1989/90

Fiscal Year	Federal	Provincial	Total
	Rs. Million		
1986/87	150	2,625	2,775
1987/88	368	3,549	3,917
1988/89	4,947	2,956	7,903
1989/90	4,492	2,667	7,159

Sources: Government of Pakistan, Economic Survey, 1989-90, and federal budget documents.

Table 6 Pakistan: Annual Releases of Wheat, 1984/85 - 1989/90

1984/85	3,695
1985/86	3,543
1986/87	3,793
1987/88	5,202
1988/89	5,717
1989/90	4,826
1990/91*	4,628

* Estimate.

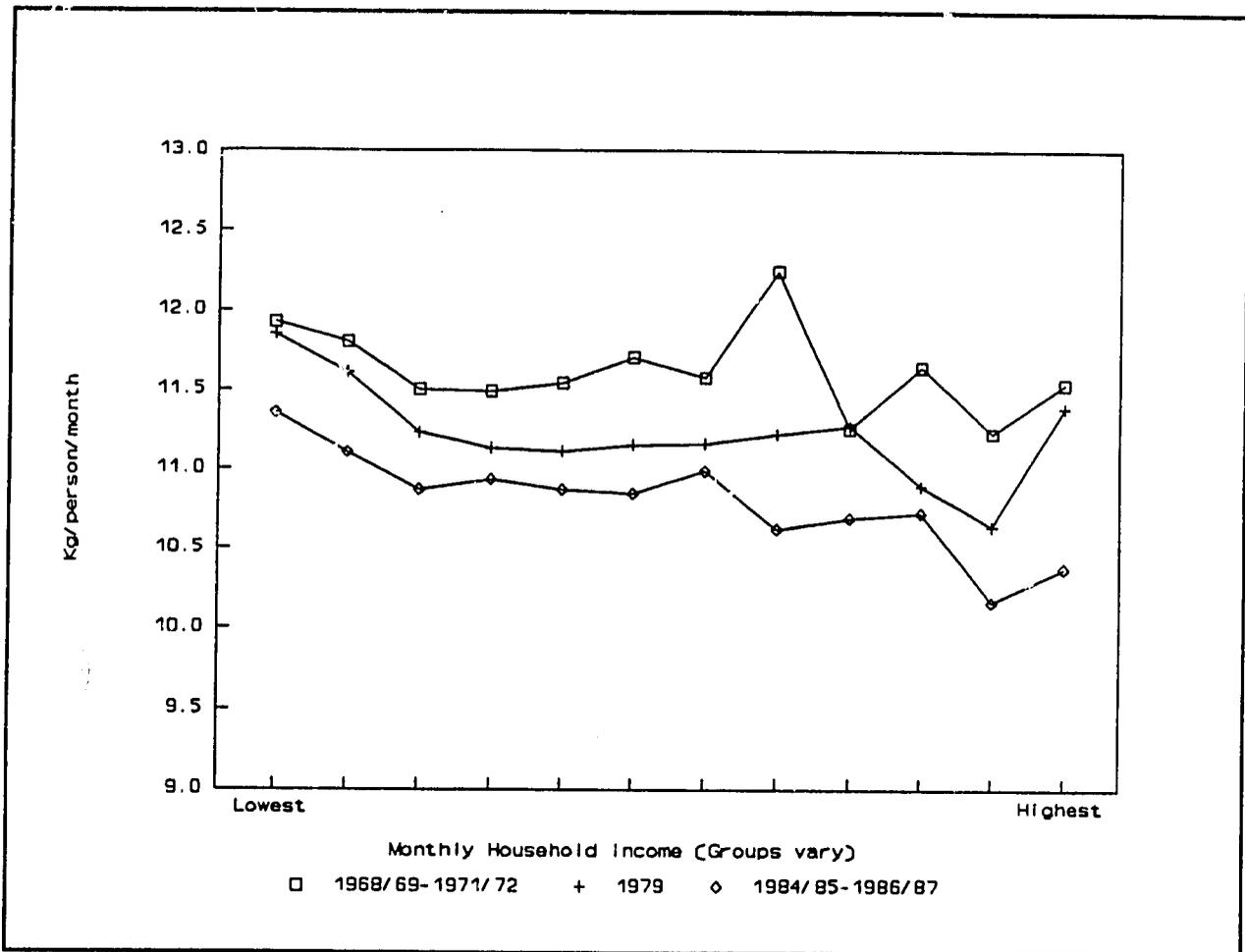
Source: Government of Pakistan, Economic Survey, 1990-91.

to undertake very expensive, subsidized imports. Whether this practice will continue under the new government is unclear.

4. WHEAT CONSUMPTION

According to Pakistan's Household Income and Expenditure Surveys (HIES), per capita consumption of wheat has declined in all income groups since the early 1970s. This trend is illustrated in Figure 2⁵. To reduce the effect of bad production years and other temporary phenomena, the results of the four surveys in the late 1960s and early 1970s are averaged, by income group. The same is done for three surveys in the 1980s.

Figure 2 Pakistan: Wheat Flour Consumed in the 1970s and 1980s, By Monthly Household Income Group (HIES)



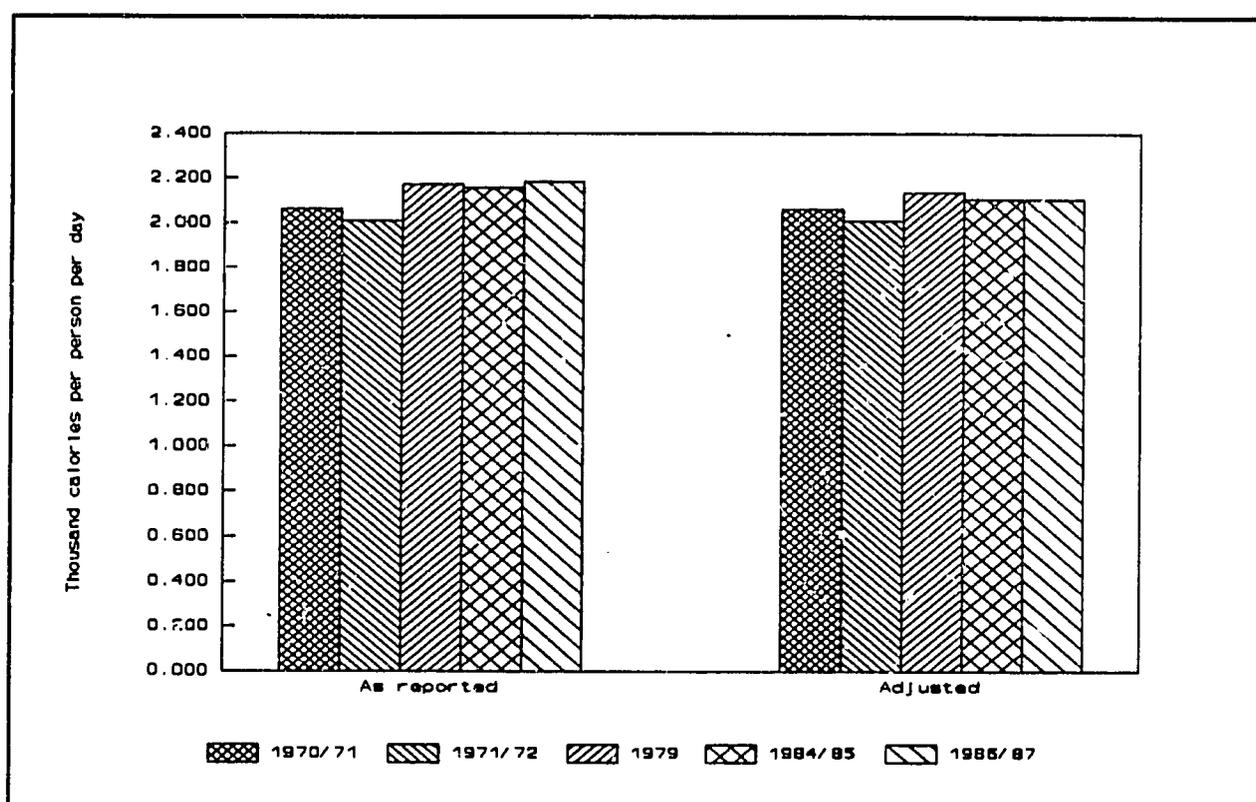
⁵ While the income variable shown here is monthly household income, monthly per capita income is observed to increase monotonically and very smoothly with household income.

Wheat consumption declined despite a substantial increase in per capita income and a decrease in the real price of wheat over the same period. Consumption of other valued foods like meat, milk, and ghee increased. Milk and ghee consumption increased over 40 and 50 percent, respectively, for the average consumer, and over 75 and 125 percent for the lowest income group. Beef consumption by the average consumer increased substantially, and marginally for the lowest income group.

Figure 3 and Figure 4 show the total calorie intakes of all income groups and the lowest income groups over time, as calculated from the HIESs⁶. Because recent surveys have added some foods to those counted, the results are displayed both on an as-reported basis and with the new foods omitted. One observes little change in the average total calorie intake. Calorie intake in the low-income group also varies little.

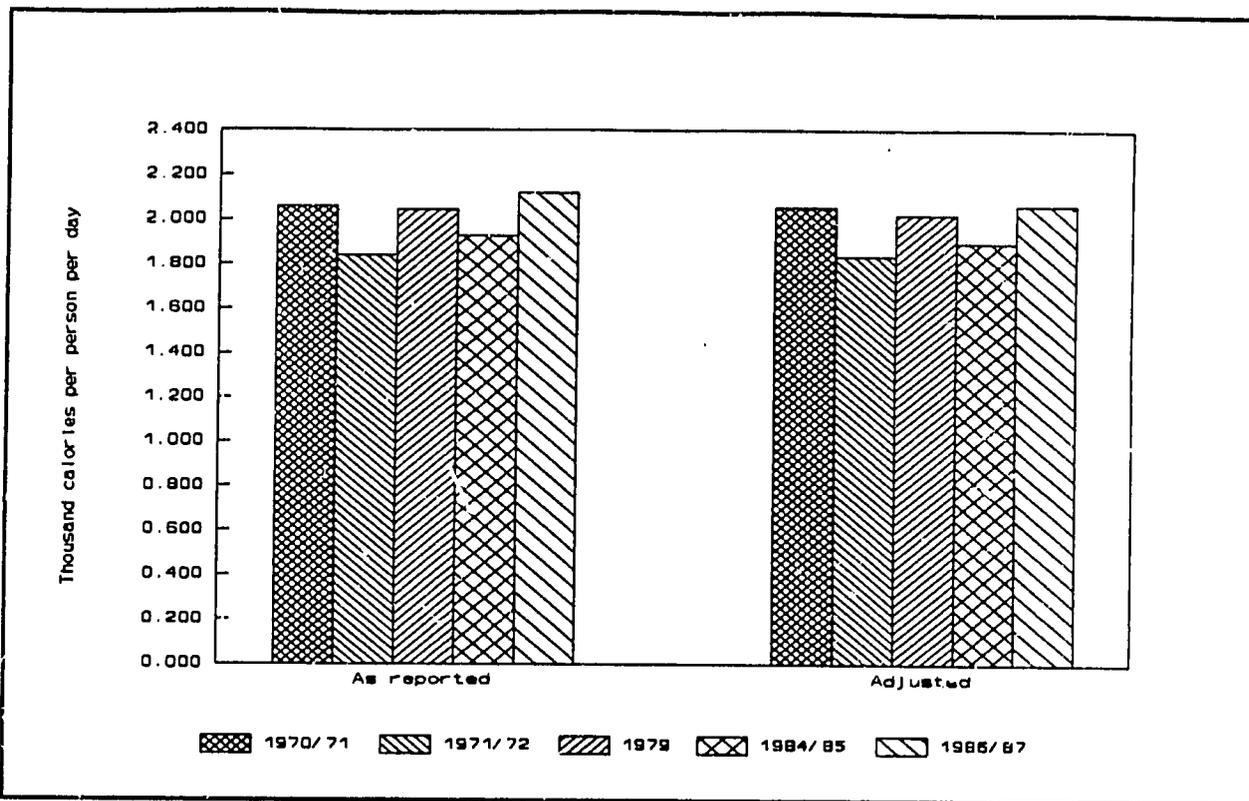
Thus as incomes rose, all groups tended to diversify their diets. They consumed about the same numbers of calories, eating less wheat and more of other foods.

Figure 3 Pakistan: Total Calorie Intake, Average of All Income Groups, All Foods Reported and Adjusted for Newly Reported Foods, 1970s and 1980s



⁶ Lack of time prevented analysis of all surveys and construction of low-income quartiles. The years chosen are representative.

Figure 4 Pakistan: Total Calorie Intake, Lowest Income Group, All Foods Reported and Adjusted for Newly Reported Foods, 1970s and 1980s



5. NET EFFECT OF POLICIES

The Government of Pakistan has been providing a subsidy on the sale of wheat. Through this subsidy, the Government transferred income to all consumers who purchase wheat flour, which is the large majority. Consumers benefitted from the low release price through its dampening effect on wholesale wheat prices, which in turn restrained increases in flour prices. The subsidy *per se* did not affect wheat producers. Because procurement prices were also kept below import parity, however, producers lost from the Government's wheat price policies.

Millers benefitted from low and constant release prices. During a given year, the retail price of wheat flour generally moved along with the wholesale (market) wheat price, while the release price of wheat remains constant throughout the year. From Figure 5 one sees that the millers' margins at the end of the year are higher than at the beginning; at that time they are buying mostly from the Government, at the release price, and they are capturing some of the subsidy. The millers' ability to jointly set flour prices helps them capture some of the subsidy at this time. On the other hand, there has been excess capacity and geographical maldistribution in the industry since the rationing period, so the overall return on investment may not be abnormally high.

Over the past twenty years, real retail flour prices have declined, whether due to the subsidy or not, yet individuals have not increased their consumption. Price stabilization was also a government objective, but presumably this could have been accomplished without depressing the price.

Nutrition may have improved marginally, but average calorie consumption did not change substantially. Nor has severe malnutrition been eliminated. The National Nutrition Survey (1985-87) found that:

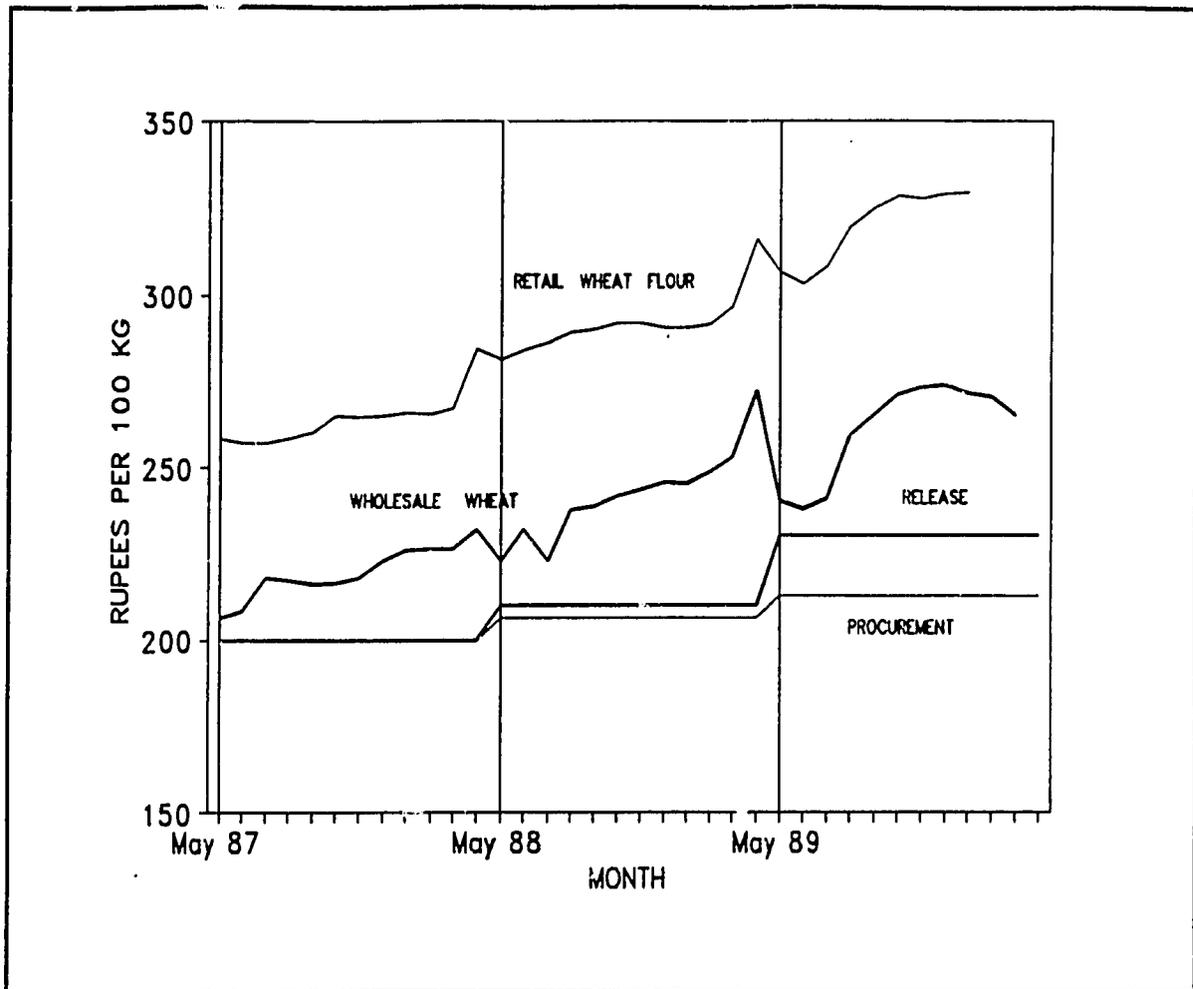
Protein-energy malnutrition and anaemia continues as a serious, widespread problem throughout the country....According to WHO criteria of weight-for-age,...10% [of young children] are severely [malnourished]⁷.

Even if severe malnutrition were half this much, it would still be disturbing.

Besides the direct fiscal cost of the wheat subsidy, there was considerable waste, use of wheat for feed, and smuggling to other countries; per capita consumption of wheat did not increase. Expenditures on health, education, and other social programs were lower than they

⁷ Pakistan, National Institute of Health, Nutrition Division, 1988, National Nutrition Survey, 1985-87, pp. vi, vii.

Figure 5 Pakistan: Wheat and Flour Prices, 1987-89

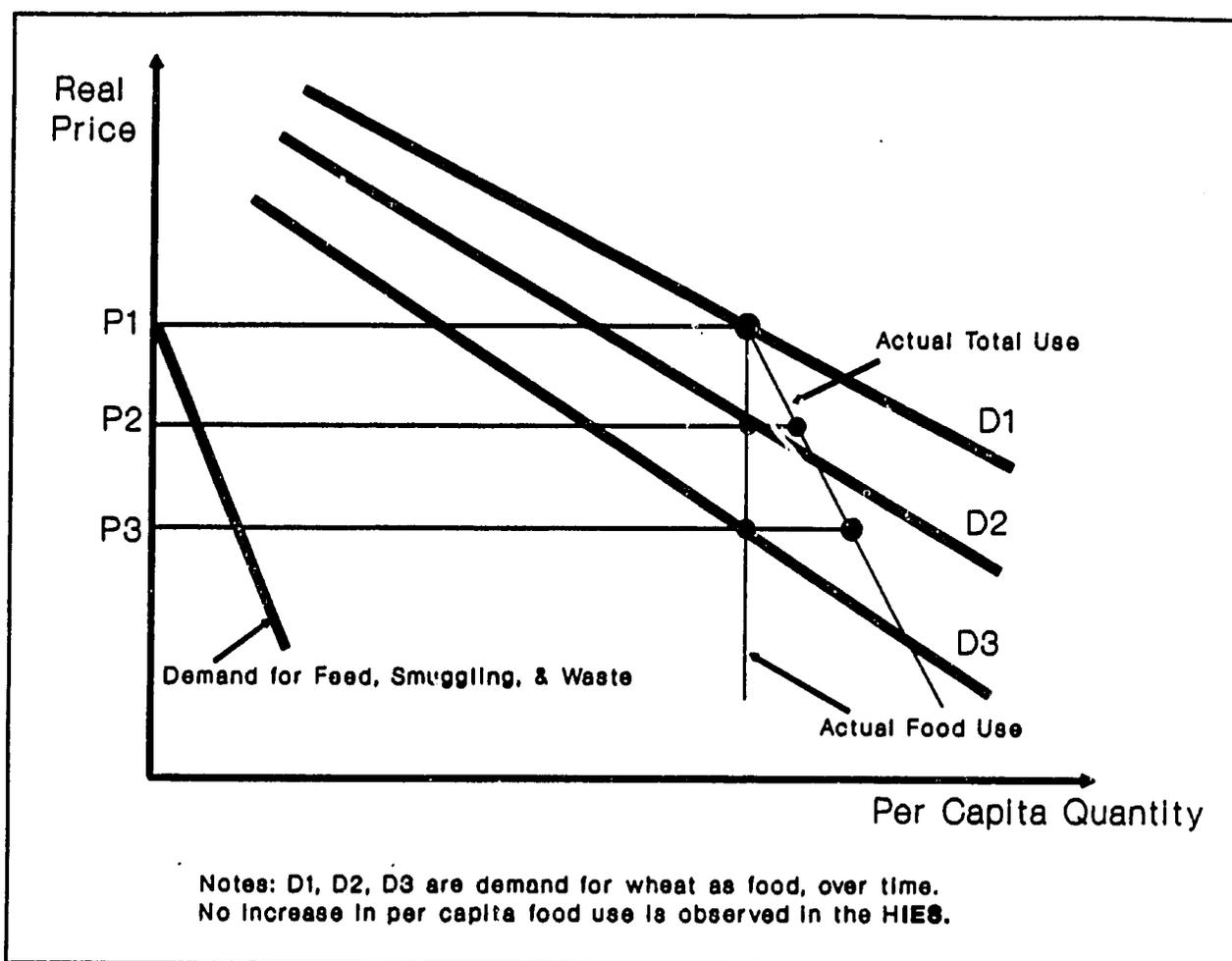


might have been⁸. More foreign exchange also had to be expended on wheat imports.

The interaction of the subsidy and wheat demand is shown in Figure 6. Per capita consumption of wheat as food ("actual food use") is shown as constant, although the case can be made that it has declined. Over time, per capita demand (D1, D2, D3) has shifted back. This offsets the effect of the decreasing real price (P1, P2, P3), which is the result of the subsidy and other factors. However, the declining price stimulates demand for other "uses," namely feed, smuggling, and additional losses. Thus, even though human consumption of wheat does not increase, total per capita disappearance ("actual total use") continues to increase. If

⁸ Sahibzada and Mahmood show that literacy in Pakistan and government expenditures on education are quite low by the standard of other comparable, Islamic countries. Sahibzada, Shahmim A. and Mir Annice Mahmood, 1989. "Education in Selected Islamic Countries, A Comparative Analysis." *Pakistan Development Review* 28:4 Part II (Winter 1989) pp. 803-27.

Figure 6 Pakistan: Food Use and Total Use of Wheat, 1970s and 1980s



one did not examine the HIES, the basic food balance data might lead one to conclude incorrectly that food consumption was rising.

The Government has recently made further progress in enlarging the gap between the release and procurement prices. In April, 1991, it announced a second increase (for 1991/92) in the procurement price. More importantly, it effected the largest single increase in the release price--over 19 percent. This raised the gap between the two prices to about 11 percent, and raised the Government's recovery of its domestic marketing costs to about 90 percent. However, the Government is not yet fully committed to removing the wheat subsidy. Moreover, as long as the domestic price remains below the world price, imports, when they are necessary, will remain subsidized.

According to the World Development Report (World Bank, 1990, p. 40), "Even countries that are often thought to have followed inequalitarian paths of development, such as Brazil and Pakistan, have succeeded in reducing the headcount index," a simple measure of the number of persons in poverty. In addition, the average income shortfall--the amount needed to get out of poverty--declined substantially in Pakistan over the past 20 years.

6. POLICY DIALOGUE

Under ASSP, USAID/Pakistan has carried on a policy dialogue with the Government of Pakistan. The duration of ASSP was envisioned as 1988-1993; the first set of benchmarks were agreed to in FY 1988. The Mission and the Government annually have agreed on a set of policy reforms ("benchmarks") that the Government will implement. For its part, USAID has provided balance of payments support, a "sector grant," to the Government. This program of policy reform and resource transfer should be understood in a broad context. USAID also cooperates with the Government in various technical projects, so the resources being transferred in any given year are not only those associated with the benchmark program. In addition USAID often coordinates the development of its benchmarks with covenants and agreements that are negotiated by multilateral donors, so the impact of the benchmark program does not depend solely on its specific resources.

USAID/Pakistan has an organizational unit (ARD/EPAD) that can do analysis to support the policy dialogue, but the staff were generally preoccupied with implementation activities. To ensure a high level of policy analysis capability, the Mission included policy project support as one of the activities in its buy-in to APAP II. Through APAP II, the author will provide technical assistance for three years. This assistance will include development and monitoring of, and supportive analysis relative to, the policy benchmarks.

The benchmark program has focused on three main objectives: 1) Bringing prices more into line with international levels, 2) Reducing GOP competition with and regulation of private sector activities, and 3) Reducing budgetary subsidies to the agricultural sector⁹. Specific benchmarks have covered wheat pricing and marketing, fertilizer pricing and marketing, and other agricultural commodities and topics.

In theory either party could suggest benchmarks, but in practice the Mission has made virtually all the proposals. This did not mean that the Government was uninterested in policy reform. Interest in and the feasibility of policy reform will always vary among the technical and political groups in the Government. An "outside" proposal to make a difficult reform, however, is often accepted more easily than an internal one would be. Thus if the discussion of a benchmark convinced the technical staff in the Government of its benefits, they could propose it and fight for its approval while retaining the ability to attribute non-acceptance or failure during implementation to an outside entity.

Once the benchmarks were approved within the Mission, they were sent to the Government. The Government's coordinator distributed them to the concerned technical experts. Mission staff would then meet with these experts directly and in more formal, negotiating sessions until technical agreement was reached. Then the set of benchmarks was submitted to the Cabinet for approval. The technical and negotiating meetings provided an opportunity for

⁹ ASSP PAAD, p.2 .

Mission staff to establish their credibility with the Government's experts as qualified and objective policy analysts.

One issue that arises in the formulation of a benchmark program is how focused or comprehensive it should be. The author's approach tends to err on the side of comprehensiveness. Under ASSP and related projects, a substantial amount of technical assistance is being provided and a significant body of research results with relevance to agricultural policy is being accumulated. The author believes that, to the extent possible, the invaluable experience gained during these technical assistance activities and studies should be incorporated in the benchmark program¹⁰. Given that previous government policies have often not been systematically developed, it is unlikely that a neat package of a few policy reforms will address the real needs of the agricultural sector at any particular time. Against this approach one can levy the criticism that implementation may be diluted by the attempt to make too many changes at the same time. Clearly Missions will have to estimate the ability of the host Government to implement the reforms that are negotiated.

The wheat release price-procurement price gap (see Table 3) has always been the most important benchmark for the Mission. The inadequate gap not only caused the Government to bear a substantial subsidy (the "Provincial" subsidies in Table 5); it also discouraged the private sector from storing wheat, a task it could probably do more efficiently than the Government. Wheat is the staple, the wage good, and, therefore, a sensitive item for the Government. Nevertheless, the Government was able to raise the release price relative to the procurement price twice before 1989/90.

In the FY 1990 benchmarks, the Government agreed that, no later than harvest time, it would raise the release-procurement price ratio to 1.15 from 1.08. In the fall of 1989, the Government raised the procurement price by 13 percent; while the increase was desirable, this made their benchmark more difficult to achieve. In particular, after it was raised, the new procurement price was higher than the current release price. The Government delayed raising the release price until well after the spring, 1990 harvest had begun. Then it raised the release price less than it had raised the procurement price, so the target ratio fell to 1.04. A month or so later, when the main marketing period was virtually over, it raised the release price further, bringing the ratio back up to 1.08.

There was some discussion of further increases in the release price, but these did not occur in 1990. Thus for the first time in the course of the ASSP policy dialogue with the USAID Mission, the Government of Pakistan did not meet a benchmark, indeed, the most important one. From discussions with the Government's technical experts, it was clear that they had recommended the implementation of the benchmark, but the Cabinet had not agreed. In August, 1990, after wheat harvesting ended, the Government was dismissed by the President, and a new government was elected in October. The Government's coordinator for the policy reform program and APAP II counterpart remained in his position.

¹⁰ In this regard, monthly meetings of all EPAD chiefs of party were very useful.

The funds that the Mission pledges to transfer to the Government under the ASSP sector grant are almost always transferred, regardless of whether the Government meets its commitments or not. This is largely because the Government of Pakistan has been promised a multi-year package of assistance with a certain total value. The form of the transfer, however, can be modified by the Mission. In this case, rather than immediately transferring the full amount as balance of payments support, that is, cash dollars, the Mission stated its intention to transfer most of the funds into a private sector commodity import program. Under this program, the Government would receive the funds several years later, when loans were recovered, in the form of Pakistani rupees. Needless to say, the Government prefers the cash transfer.

APAP's resident advisor and Mission technical personnel had assessed the Government's overall performance on the FY 1990 benchmarks¹¹. They had recommended a higher level of cash grant than that contemplated by the Mission Director. They reasoned that overall performance, even if heavily weighted for the importance of the wheat pricing benchmark, still warranted a higher level. Moreover, the process of the policy dialogue had achieved more than a moderate level of success, and a very low sector grant would be discouraging to those technical and managerial personnel in the Ministry of Food and Agriculture who had taken considerable risk in advocating a difficult action to the Cabinet.

The resolution of the level of the sector grant was complicated by two major events: the removal of the PPP government by the President of Pakistan¹² and the subsequent election of an IJI government, and the non-certification of the Pressler Amendment by the President of the United States. Meanwhile, the new Government has made good and timely progress on the wheat issues, including both the level of the procurement price relative to the world price and the contentious issue of the procurement-release price gap. Even in the absence of a sector grant, it may be possible to continue a meaningful policy dialogue.

¹¹ The assessment also includes the reforms agreed to by the Government for the coming year, in this case the FY 1991 benchmarks.

¹² The Eighth Amendment to the current Constitution gives the President substantial powers which balance those of the Prime Minister. The President can dismiss the National Assembly, and consequently the Prime Minister, for the following reasons: threat to national security, failure to maintain law and order, excessive corruption.

7. LESSONS LEARNED FROM USAID-GOP POLICY DIALOGUE

Through APAP II's involvement in the policy reform process in Pakistan, the following lessons have been learned.

7.1 Major Progress Possible through Policy Dialogue

Through policy dialogue, a Mission can make major progress toward achieving policy objectives like removing subsidies, reducing price distortions, or promoting privatization. Policy benchmarks can also be useful in reinforcing project activities in institutional strengthening.

This has clearly been the case in Pakistan. There the Mission has succeeded in convincing the Government to reduce or remove subsidies on wheat marketing and fertilizer; reduce price distortions, particularly in wheat; and advance privatization in sectors like fertilizer and edible oil.

7.2 Missions Require Policy Analysis Capability

In order to make progress in policy reform, USAID Missions must have a high level of policy analysis capability available to them. While this function is not entirely new to USAID, the pressure of implementing projects on a day-to-day basis often takes precedence over longer-run activities like analysis. Ancillary necessities like databases and libraries, which are crucial to policy analysis, may also receive little attention from personnel preoccupied with other business.

At any given time there were often several qualified policy analysts among the staff of the Office of Agriculture and Rural Development in USAID/Islamabad. However, these individuals also had significant responsibility for projects, including institutional strengthening projects in the data collection and policy analysis areas. Thus the Mission found it particularly convenient to have at least one individual who did not have implementation responsibilities. This APAP II advisor also coordinated research and training activities that complemented the policy dialogue.

7.3 Flexibility of Balance-of-Payments Support Limited

The "sector grant" (*i.e.*, balance-of-payments support, or fast-disbursing assistance) is in general not flexible enough to send different signals to technical experts and to politicians. That is, when there is a division of opinion in the Government, only one group can be "rewarded." The stated purpose of the grant is to provide resources which can be used by the Government to overcome difficulties that may arise from the implementation of the agreed-upon changes in policy. Politicians benefit from this aspect of the grant. The higher the grant, the better. A grant, however, also serves to demonstrate the effectiveness of those technical and management personnel who interact with the donor agency. Since the role of these individuals is often pivotal in convincing politicians to change policy, it is important to give them appropriate support as

well. Indeed their role is likely to carry over from year to year; their longevity in their key positions may be more than that of their Ministers.

The dialogue regarding wheat price policy in Pakistan is described above. When the Cabinet balked at making the change in policy, the Mission felt that this particular objective was so important that a very strong message needed to be sent to the political echelons of the Government via the amount of the sector grant. In the process it risked losing some of the ground it had gained in establishing a strong working relationship with senior technical personnel. Happily the APAP II counterpart in the Government is a professional public servant who intends to continue the policy dialogue despite the loss of sector grant funds¹³.

7.4 Additional Range Possible in Resource Transfer

Generally a Mission can design its resource transfer so that in the event of complete disapproval of the Government's compliance with agreed-upon benchmarks, the transfer would be zero. Pakistan's situation--*de facto* lack of a "zero option"--seems to be somewhat unusual in that a multi-year package of assistance was promised to the Government. The "zero option" would presumably give a Mission additional leverage to encourage implementation. How often such an option would be exercised would still depend, however, on how inclined Missions were to disburse resources.

7.5 Dialogue May Continue Despite Change of Administration

Changes of government may not be damaging to a policy dialogue if technical experts remain in positions of influence. Technical and negotiating meetings provide an opportunity for Mission staff to establish their credibility with the Government's experts as qualified and objective policy analysts. Dialogue complemented by targeted training can be particularly productive.

Although a new government was elected in October, 1990, the Government's coordinator for the policy reform program remained in his position. This individual participated in a high-level training program on agricultural policy and macroeconomics in the summer of 1990, and returned to Pakistan even more enthusiastic about pursuing a rational policy dialogue. He intends to continue these interactions even in the absence of the sector grant.

On the other hand, political weakness may prevent implementation of a benchmark or cause backsliding. The Benazir Bhutto administration could not agree to increase the price of flour, partly because its political mandate was not very strong.

¹³ Sector grant funds for FY 1991 are unavailable due to non-certification of the Pressler amendment.

7.6 Formal Benchmarks Can Improve Policy Implementation

If the Government makes a policy objective a "benchmark," it may help its implementation. That is, formalizing the Government's acceptance of a proposed action may prevent slippage of support from certain quarters within the Government.

The Government cites the creation of the Agribusiness Cell in the Ministry of Food, Agriculture, and Cooperatives as an example. The Mission concurred with the Government's proposal to create such a unit. Indeed it was a recommendation of one of the Mission's projects. Inclusion in the benchmark agreement helped to maintain support in the Government for this plan.

7.7 LDCs Relinquish Taxation of Farmers Slowly

The final lesson is based on the experience of many developing countries, but is no less valid to the case of Pakistan.

There is a strong tendency for (developing) countries to favor (or even treat neutrally) the agricultural producer only as national income increases and the share of agriculture (producers) decreases. There is fiscal logic to this tendency, in that it is burdensome for a small part of the population to transfer resources to a larger part. Thus the availability of revenue from the agricultural sector may limit the pace of some agricultural policy reforms. As long as agriculture remains a large sector, giving up the taxation of producers is difficult for a government because traditional revenue sources are few.

In Pakistan the effect of the Government's policies has been to tax the agricultural sector¹⁴. Over the past several years, the Government has moved hesitantly in reducing subsidies to wheat consumers and realigning producer prices upward toward the level of world prices. Nevertheless, the recent substantial upward revision in the release price and the absence of a significant protest by consumers is a positive sign. Indeed the Government currently seems more concerned about protests from some farmers that they are being "squeezed" by the Government's input and output price policies.

¹⁴ Cf. Ender, Gary, 1990. Government Intervention in Pakistan's Agricultural Economy. Staff Report No. 9027, Economic Research Service, USDA; Dorosh, Paul and Alberto Valdés, 1990. Effects of Exchange Rate and Trade Policies on Agriculture in Pakistan. Research Report No. 84, International Food Policy Research Institute.

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